

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF TENNESSEE
SOUTHERN DIVISION

In re

NORA LYNN NEWELL

Debtor

No. 04-13285

Chapter 13

MEMORANDUM

Appearances: Mark T. Young, Chattanooga, Tennessee, Attorney for Debtor,
Nora Lynn Newell

M. Kent Anderson, Assistant United States Attorney, Eastern
District of Tennessee, Attorney for the United States

Cara J. Alday, Patrick, Beard, Schulman & Jacoway,
Chattanooga, Tennessee, Attorney for Finley Wilhoite

Carol Walker Carter, Chattanooga, Tennessee, Attorney for C.
Kenneth Still, Chapter 13 Trustee

R. Thomas Stinnett, United States Bankruptcy Judge.

The Internal Revenue Service released its tax liens on the debtor's property after the debtor filed this chapter 13 case. The IRS based its decision to release the liens on the value of the debtor's property. The chapter 13 trustee, however, thought that the asset schedules filed by the debtor undervalued her real property, and as a result, he objected to confirmation of the proposed chapter 13 plan. The chapter 13 trustee's action apparently prompted the IRS to file the motion that is the subject of this memorandum. The motion asks the court for relief from the automatic stay so that the IRS can revoke the lien release and reinstate the tax liens. 11 U.S.C. § 362(d). The facts are set out below in more detail.

The IRS filed tax lien notices in September, October, and December 1996. The tax liens secured tax debts for the years 1989 through 1995. The tax debts totaled more than \$165,000. The debtor filed a chapter 7 bankruptcy case on December 2, 2003. The IRS refiled lien notices on December 16, 2003. See 11 U.S.C. §§ 362(b)(3) & 546(b) (not an automatic stay violation). The debtor received a discharge of her debts on April 26, 2004. The chapter 7 case was closed as a no-asset case.

Since the tax liens were not avoided in the debtor's chapter 7 case, the discharge of the tax debts did not necessarily prevent the tax liens from being enforceable. The tax liens remained effective on the debtor's property that was subject to the tax liens at the beginning of debtor's chapter 7 case and passed out of the chapter 7 bankruptcy estate. *Dishong v. United States (In re Dishong)*, 188 B.R. 51 (Bankr. M. D. Fla. 1995). The IRS essentially had a claim secured by the debtor's property but not enforceable against the debtor personally.

After entry of the discharge in the debtor's chapter 7 case, the insolvency section of the IRS's Nashville office requested a review of the file. The purpose of the review was to

determine whether enforcement of the tax liens against the debtor's property was likely to produce any payment to the IRS. The file was referred to a bankruptcy specialist in the IRS's Knoxville office. She understood that the tax debts had been discharged, but the liens survived. The bankruptcy specialist carefully reviewed the schedules in the debtor's chapter 7 case. She concluded that the debtor's property did not have enough value for enforcement of the tax liens to produce any payment to the IRS. She directed that the discharged tax debts be abated. This occurred about May 25, 2004. Abatement of a tax debt automatically leads to the release of the tax lien securing the debt *unless* special instructions are sent to the IRS's lien department.

When the bankruptcy specialist directed abatement of the tax debts, she did not know that the debtor had filed a chapter 13 case a few days earlier, on May 21, 2004. The chapter 13 case was entered in the IRS's system on June 2, 2004. The first notice of the chapter 13 case in the IRS's chapter 7 file was an entry dated June 4, 2004. The bankruptcy specialist obtained the debtor's schedules in the chapter 13 case about June 9, 2004. After reviewing the chapter 13 schedules, she concluded again that the value of the property did not justify enforcement of the tax liens. As a result, she did not take any action to prevent the earlier abatement of the taxes from causing the IRS to release the tax liens. The IRS released the liens about June 23, 2004. The debtor's proposed chapter 13 plan, however, provided that the IRS would be paid an allowed secured claim of \$4,100.

The IRS filed an objection to confirmation of the debtor's proposed chapter 13 plan on June 23, 2004. The objection was not based on failure to treat the IRS as having an allowed secured claim. The meeting of creditors in the chapter 13 case was held on June 30, 2004. The debtor's schedules revealed three parcels of real property that she owned when

she filed her earlier chapter 7 case and when she filed this chapter 13 case. The chapter 7 trustee abandoned the property. He did not attempt to sell it to obtain any value that could be used for payments on unsecured claims – value over and above unavoidable liens and exemptions. The chapter 13 trustee, however, obtained an appraisal and concluded that the real property was significantly undervalued in the schedules. This caused the chapter 13 trustee to file an objection to confirmation on the ground that if this were a chapter 7 case, a sale of the land would produce money (equity) for payment on unsecured claims, but the proposed chapter 13 plan did not provide for payment on the unsecured claims of the amount of the equity plus interest. 11 U.S.C. § 1325(a)(4). The trustee's other grounds for objecting to confirmation are not relevant to the question before the court. The IRS subsequently filed its motion to lift the automatic stay so that it can reinstate the tax liens.

The debtor and the chapter 13 trustee objected to allowing the IRS to reinstate the tax liens. Mr. Finley Wilhoite has also appeared by counsel and objected to allowing the IRS to reinstate its tax liens. Mr. Wilhoite contends that he has a judgment lien on the debtor's property, the judgment lien passed through the debtor's chapter 7 case unaffected, the judgment lien moved up in the order of priority when the tax liens were released, and the tax liens should not regain priority over his judgment lien by being reinstated.

DISCUSSION

When the debtor filed her chapter 13 case, the IRS had perfected tax liens on her property. If the property was worth more than the debts secured by other, higher priority liens, then the IRS had an allowed secured claim. 11 U.S.C. § 506(a). The chapter 13 trustee's objection to confirmation under § 1325(a)(4) supports the idea the debtor's property is worth enough for the IRS to have an allowed secured claim. The court assumes that if the

tax liens are reinstated, then the IRS will have an allowed secured claim for some amount. Based on this assumption, the court can also assume that reinstatement of the tax liens will reduce the chapter 13 plan payout on unsecured claims. First, it will reduce the amount the debtor must pay on unsecured claims under § 1325(a)(4). Furthermore, if the debtor wants to keep the property securing the tax liens, the required payments on the IRS's allowed secured claim will use money that would otherwise be used to pay unsecured claims. 11 U.S.C. § 1325(a)(5)(B). The effect on unsecured claims is the basis of the chapter 13 trustee's objection to reinstatement of the tax liens.

The chapter 13 trustee contends that the relevant tax statute does not allow the IRS to revoke the release and reinstate the tax liens. The statute provides that the IRS can revoke a lien release that was issued erroneously or improvidently. 26 U.S.C. § 6325(f)(2). The trustee contends the IRS did not erroneously or improvidently release the liens because the IRS made no mistakes in the process of deciding the value of the property, and the decision on value made it legally correct for the IRS to release the tax liens. The IRS doubtlessly knew that the values given in bankruptcy schedules may be inaccurate, but it was entitled to rely on the scheduled values. The debtor certified under penalty of perjury that the schedules were correct. Fed. R. Bankr. P. 1008. Furthermore, the IRS knew that the chapter 7 trustee in the debtor's earlier case had abandoned the property. The scheduled values supported abandonment on the ground that a sale of the debtor's property would not produce any money for distribution on unsecured claims. 11 U.S.C. § 554(a). The chapter 7 trustee's abandonment indicated his agreement with this view, and consequently, his opinion that the scheduled values were not too far wrong. Thus, according to the chapter 13 trustee, the IRS did not erroneously or improvidently reach its decision as to the value of the property, and therefore, it makes no difference that the valuation turned out to be wrong.

In the alternative, the chapter 13 trustee might argue that the IRS could have investigated the value of the property, but its decision to rely completely on the scheduled values was logical or reasonable, and therefore, it can not be viewed as erroneous or improvident.

The wording of the tax statute suggests that whether the IRS erroneously or improvidently issued the lien release can be decided entirely by hindsight: if the facts show the release should not have been granted, then the release was granted erroneously or improvidently. The court need not go that far in interpreting the tax statute. The court can assume that fairness to the taxpayer is a factor in interpreting “erroneously or improvidently.” The chapter 13 trustee’s interpretation is still too narrow. The IRS’s decision to release the tax liens was erroneous or improvident because it was based on wrong or misleading information – even though the IRS’s decision to rely on the information was logical or reasonable. The IRS was entitled to rely on the information provided by the debtor in the asset schedules – even though her interest in valuing the property was adverse to the IRS’s interest. The debtor can hardly argue that the IRS should not have relied on the scheduled values that she certified as correct. Likewise, a debtor should not be rewarded for giving inaccurate values in the schedules. The courts should discourage debtors from carelessly or intentionally giving inaccurate values for their own benefit. Between the debtor and the IRS, the court sees no good reason for holding that the lien release can not be revoked because it was not erroneously or improvidently granted.

As to the chapter 13 trustee, the court has assumed that reinstating the IRS’s tax liens will reduce the chapter 13 payout to unsecured creditors. The evidence does not show, however, that creditors or the chapter 13 trustee, in reliance on the release of the tax

liens, took any actions that will be detrimental to them if the tax liens are reinstated. The existence of the chapter 13 case should have prevented any such detrimental reliance by the creditors or the chapter 13 trustee. Allowing the IRS to revoke the release and reinstate the tax liens will not be inequitable to creditors generally. It will simply restore the situation to the way it was when the debtor filed her chapter 13 case. *ORNL Federal Credit Union v. Wilson (In re Wilson)*, 261 B.R. 664 (Bankr. E. D. Tenn. 2001); *In re Megamarket of Lexington, Inc.*, 207 B.R. 527 (Bankr. E. D. Ky. 1997).

Along the same line, the chapter 13 trustee might argue that reinstatement is not allowed or should not be allowed because his avoiding powers gained priority over the IRS's rights when it released the tax liens. 26 U.S.C. § 6323(f)(2); *United States v. Winchell*, 793 F.Supp. 994 (D. Colo. 1992) (release & reinstatement resulted in priority of pre-release transfer). The chapter 13 trustee acquired the avoiding powers at the moment the debtor filed her chapter 13 case. 11 U.S.C. §§ 544(a), 545, 547 & 548. Some of the avoiding powers gave the chapter 13 trustee the rights of a bona fide purchaser from the debtor or a creditor with a judgment lien on the debtor's property. 11 U.S.C. §§ 544(a) & 545. The bankruptcy statutes bestowed these rights and powers on the chapter 13 trustee for the purpose of avoiding pre-bankruptcy transfers and liens for the benefit of creditors. The chapter 13 trustee did not actually become the holder of a new judgment lien on the debtor's property or the owner of a bona fide purchaser's interest in the debtor's property. See generally 11 U.S.C. §§ 323, 541-543, 546, & 363-365.¹ Since the IRS mistakenly released the tax liens during the debtor's chapter 13 case, the court has the equitable power to allow the IRS to re-attach and re-perfect

¹ Section 549 on avoidance of post-petition transfers apparently does not apply to a transfer of bankruptcy estate property for the benefit of the debtor and the estate, which was the effect of the IRS's lien release. 11 U.S.C. § 549.

the liens and attempt to regain the status it had when the debtor filed the chapter 13 case. The question is the same as before. Did the chapter 13 trustee or creditors take actions after the lien release, and in reliance on it, that can not be undone and that will result in detriment to them if the lien is reinstated? In this case the court sees no good equitable reason for denying the IRS the right to revoke the release and reinstate the lien. *ORNL Federal Credit Union v. Wilson (In re Wilson)*, 261 B.R. 664 (Bankr. E. D. Tenn. 2001); *In re Megamarket of Lexington, Inc.*, 207 B.R. 527 (Bankr. E. D. Ky. 1997).

Likewise, the court can treat the reinstated tax lien as having the same priority against the chapter 13 trustee that it had when the debtor filed her bankruptcy petition. In this regard, the tax statute provides that a lien notice filed after revocation of a lien release takes effect only from the time of filing. The tax lien does not have priority based on a lien notice that was filed before the release. 26 U.S.C. § 6323(f)(2); *United States v. Winchell*, 793 F.Supp. 994 (D. Colo. 1992). Nevertheless, between the IRS and the bankruptcy estate, the court can treat the tax lien as having the same priority it had when the debtor filed the bankruptcy case. This result is a matter of bankruptcy law, not tax law.

In this regard, the bankruptcy court in the *Green* case never reached the question of whether it could lift the automatic stay to allow the IRS to revoke a post-petition lien release and reinstate the tax lien. *In re Green*, 310 B.R. 772 (Bankr. M. D. Fla. 2004).

The parties have not discussed the effect of abatement of the tax debts, which was a step the IRS took in the process of releasing the tax liens. Apparently, the abatement should not make any difference to whether the IRS can revoke the release and reinstate the tax liens without violating the debtor's chapter 7 discharge. Since the tax debts had been discharged anyway, the court sees no reason to be concerned with the effect of abatement.

When the debtor filed this chapter 13 case, she was no longer liable for the tax debts but her property was liable because the tax liens passed through the chapter 7 case. The actions of the IRS or the court do not affect the chapter 7 discharge so long as the purpose is only to preserve the tax lien on the property that was subject to the lien at the beginning of the chapter 7 case. 11 U.S.C. § 524; *United States v. Buckner*, 264 B.R. 908 (N. D. Ind. 2001); *In re Landmark*, 48 B.R. 626 (Bankr. D. Minn. 1985).

This leaves the question of whether reinstatement of the tax liens should be denied because it will prejudice Mr. Wilhoite's judgment lien on the debtor's property. If there were no bankruptcy case involved, the release and reinstatement of the tax liens could give Mr. Wilhoite's judgment lien priority over the tax liens. 26 U.S.C. § 6323(f)(2); *United States v. Winchell*, 793 F.Supp. 994 (D. Colo. 1992). Reinstatement of the tax liens does not necessarily mean that the court will determine priority against another lien according to the facts when the debtor filed this chapter 13 case. The court reached that result as to the chapter 13 trustee, but Mr. Wilhoite is not in the same position as the chapter 13 trustee. Mr. Wilhoite's judgment lien can be treated differently from the chapter 13 trustee's rights and powers. The court can reserve the question of priority between Mr. Wilhoite's judgment lien and the reinstated tax liens. The court should reserve the question because it has assumed that Mr. Wilhoite has an unavoidable judgment lien. The court will enter an order allowing the IRS to revoke the release and file a new lien notice but reserving the question of priority between the IRS's tax liens and Mr. Wilhoite's judgment lien.

This memorandum constitutes the court's findings of fact and conclusions of law. Fed. R. Bankr. P. 7052.

ENTER:

BY THE COURT

R. THOMAS STINNETT
UNITED STATES BANKRUPTCY JUDGE

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF TENNESSEE
SOUTHERN DIVISION

In re

NORA LYNN NEWELL

Debtor

No. 04-13285

Chapter 13

ORDER

In accordance with the court's memorandum opinion entered this date,

IT IS ORDERED that the automatic stay is lifted so that the United States, acting through the Internal Revenue Service, can revoke the release of tax liens as to the debtor, Nora Lynn Newell, that was entered on or about June 23, 2004, and can take the additional steps required to reinstate the tax liens, including the filing of tax lien notices, but provided the tax liens will apply only to property to which they applied on December 2, 2003, when the debtor, Nora Lynn Newell, filed her chapter 7 bankruptcy case;

IT IS FURTHER ORDERED that the reinstatement of the tax liens will not automatically give them priority over the judgment lien of Finley Wilhoite, and the court will subsequently decide the question of priority between his judgment lien and the reinstated tax liens *if* it is necessary for administration of this chapter 13 case.

ENTER:

BY THE COURT

R. THOMAS STINNETT
UNITED STATES BANKRUPTCY JUDGE